

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

Report of Examination

of

**GULF COAST TITLE INSURANCE COMPANY,
INCORPORATED**

Foley, Alabama

As Of

December 31, 2002

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STATE OF ALABAMA

COUNTY OF BALDWIN

Anne L. Ward, being first duly sworn, upon her oath deposes and says:

THAT she is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *GULF COAST TITLE INSURANCE COMPANY, INC.*, for the period of January 1, 1998 through December 31, 2002;

THAT the following 54 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

AND THAT the statements, exhibits, and data therein contained are true and correct to the best of her knowledge and belief.

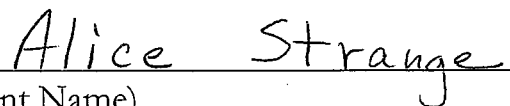


Examiner-in-Charge

Subscribed and sworn to before the undersigned authority this 3rd day of November, 2004.



(Signature of Notary Public)

 Notary Public
(Print Name)

in and for the State of Alabama.

My Commission expires 4-06-06.



BOB RILEY
GOVERNOR

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FINANCIAL/EXAMINATION DIVISION

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November 3, 2004
Foley, Alabama

Honorable Walter A. Bell
Commissioner of Insurance
State of Alabama
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Dear Commissioner:

Pursuant to your authorization and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2002, has been made of the affairs and financial condition of

GULF COAST TITLE INSURANCE COMPANY, INCORPORATED

at its home office located at 315 East Laurel Avenue, Foley, Alabama 36535. The report of examination is submitted herewith.

Where the description "Company" or "GCTIC" appears herein, without qualification, it will be understood to indicate *Gulf Coast Title Insurance Company, Incorporated*.

SCOPE OF EXAMINATION

A full scope combined financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the resolutions, regulations and bulletins of the State of Alabama, Department of Insurance (ALDOI); in accordance with the applicable procedures and guidelines promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards in connection with the verification of assets and determination of liabilities.

The Company was last examined for the five-year period ended December 31, 1997, by examiners representing the ALDOI. The current examination covers the intervening period from the date of the last examination through December 31, 2002, and was conducted by examiners from the ALDOI. Where deemed appropriate, transactions subsequent to 2002, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2002, as shown in the financial statements contained herein. However, the discussion of assets and liabilities contained in this report has been confined to those items where a material change was made by the examiners, or which indicated a violation of the *Alabama Insurance Code* and the ALDOI's rules and regulations or other insurance laws or rules, or which were deemed to require comments and/or recommendations.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2002. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through the date of the examination report, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities. An office copy of the Company's filed Annual Statement for 2002, was compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's

territory, plan of operation, operations/management, complaint handling, marketing and sales, producer licensing, underwriting and rating, claims, and privacy policies and practices.

The examination was conducted concurrently with the examination of Baldwin Mutual Insurance Company, Incorporated (Baldwin Mutual), the Company's majority stockholder.

ORGANIZATION AND HISTORY

The Company was organized in Foley, Alabama, on September 22, 1978, under the laws of the State of Alabama. The Certificate of Incorporation was filed for record in the office of the Judge of Probate, Baldwin County, Alabama, on November 16, 1978.

The objects of incorporation, as stated in the Certificate of Incorporation, were to guarantee "to conduct the business of a title insurance company as defined and accepted under the statutes and laws of the State of Alabama, including, but not limited to, entering into a contract of title insurance by agreement whereby insurer, for a valuable consideration, agrees to indemnify insured in a specified amount against loss through defects in the title to real estate, wherein insured has an interest, either as a purchaser or otherwise; entering into a contract to indemnify against loss through defects in the title to real estate or liens or encumbrances thereon; and to enter into a contract of insurance against defects in title, un-marketability, liens and encumbrances."

At the date of incorporation, the authorized capital stock was \$200,000 divided into 10,000 shares of the par value of \$20 per share. The Company commenced business with paid-up capital of \$200,000 and paid-in surplus of \$300,000. No changes have occurred in the authorized capital since the Company commenced business.

Baldwin Mutual made a \$270,000 surplus contribution at year-end 1991.

At the December 31, 2002 examination date, the Company's Annual Statement reflected outstanding capital stock totaling \$200,000, consisting of 10,000 shares of *Common capital stock* authorized and issued, with 45 shares held as treasury stock; *Gross paid in and contributed surplus* of \$572,537; and \$(228,587) in *Unassigned funds (surplus)*.

No amendments to the Articles of Incorporation or By-Laws occurred during the current examination period.

MANAGEMENT AND CONTROL

Stockholders

The Company was a stock corporation with ultimate control vested in its stockholders. At December 31, 2002, the majority stockholder was Baldwin Mutual, which owned 91.76 percent of the common stock of the Company. Four individuals each held 2.05 percent of the remaining stock.

Board of Directors

The By-Laws provided that the control and management of the affairs, property and interests of the Company shall be vested in its Board of Directors (BOD). The BOD shall be composed of nine persons, who need not be shareholders, with each director serving a three-year term, and one-third of the terms expiring each year.

The annual meeting of the BOD shall be held immediately following the annual meeting of the shareholders. In addition, it was noted that the BOD held regular monthly meetings during the examination period, whereby the officers updated the BOD members on the financial progress of the Company and other significant management matters. During said meetings, the BOD authorized any significant management matters undertaken by the officers of the Company.

The members of the BOD serving at December 31, 2002, were as follows:

Director/Residence

Principal Occupation

Carl Emery Johnson
Foley, Alabama

CPA

Paul (NMN) Kaiser, Jr.
Foley, Alabama

Retired Farmer

Clair Dean Hansen
Foley, Alabama

Country Commissioner

Arthur Abel Holk
Foley, Alabama

Chairman of the Board

William Henry Riemer
Elberta, Alabama

Retired Farmer

Ralph Timothy Russell
Foley, Alabama

President, and Comptroller
of the Company

Paul Frederick Schultz
Foley, Alabama

Retired Petroleum Distributor

Samuel Francis Parker
Foley, Alabama

Retired CPA

It was noted that long time BOD member, James Walter Clark, died during 2001, and had not been replaced at the examination date. The Company's By-Laws stipulate that an empty position can be filled for the unexpired term by the remaining directors.

The minutes of the BOD did not reflect evidence that the independent auditor's report had been presented to the BOD in accordance with Article VII of the Company's By-Laws.

It was noted that the previous examination report noted similar discrepancies in the minutes of the BOD meetings; the Company did not comply with the recommendations in the *Report of Examination As Of December 31, 1997*.

Officers

Article IV of the By-Laws stated that the officers of the Company shall consist of a President, two Vice Presidents, a Secretary and a Treasurer all elected by the BOD to serve one year "until the annual meeting...next succeeding his election, and until his successor shall have been elected and qualified, or until his death, resignation or removal." The following officers were serving at December 31, 2002:

<u>Officer</u>	<u>Title</u>
Arthur Abel Holk	Chairman of the Board
Ralph Timothy Russell	President
Samuel Francis Parker	Secretary
Clair Dean Hansen	Treasurer

It was noted that two Vice Presidents had not been elected by the Board of Directors

in accordance with the provisions stipulated in the By-Laws. This discrepancy was also noted during the previous examination.

Management Contract

A management agreement with the Executive Vice President of the Company (Manager) was approved February 29, 1980, by the BOD, and became effective on March 17, 1980. This agreement provided that the Company pay the Manager a salary equal to three percent (3%) of all premiums collected and, in addition, an annual bonus of ten percent (10%) of the Company's net income computed before the deduction of the bonus and before any federal and state taxes.

In return for the aforesaid consideration, the Manager agreed "to manage, supervise and promote the general interest of the Company to his best ability."

The contract further provided that the agreement would remain in force and effect until either the Manager or the Company gave the other party six months notice, in writing, of the termination of the contract. The contract may be terminated by the Company in the event that the Manager commits fraud, felony, or at his death.

During the course of the previous examination, the examiners raised the issue of whether the *Management Contract* violated ALA. CODE § 27-27-26(a) (1975). On July 19, 2000, an administrative hearing was held by the ALDOI regarding this matter. On September 20, 2000, the Acting Commissioner of Insurance issued an *Order*, which stipulated, in pertinent part, the following:

"...it is hereby ORDERED the examination report of Baldwin Mutual Insurance Company, Inc. and Gulf Coast Title Insurance Company, Inc., be amended to reflect the Commissioner's decision to allow Mr. Russell's compensation agreement to remain in place until such time as it shall be substantially changed or modified. Furthermore, this decision applies solely to the employment contract of Mr. R. Timothy Russell and does not apply to any other individual so employed at the companies nor does it apply to any officer or director of Baldwin Mutual or any other Alabama domestic insurer."

Conflict of Interest

The Company followed an established procedure, adopted by the BOD on June 15, 1981, for the annual disclosure, in writing to the BOD, of any material interest or affiliation on the part of its officers or directors, which is in, or likely to, conflict with the official duties

of such person.

The conflict of interest statements for the period under examination were reviewed. Mr. Holk disclosed his affiliation with State Farm Insurance. No exceptions were noted.

It was noted that the Company's Chief Investment Officer is the son of the President. The relationship between these individuals meets the "related person" criteria as defined in Section 10-2B-8.60 of the *Alabama business corporation act*. Item (1) of said section delineates "conflicting interest." The relationship was not disclosed by the President in accordance with item (4) of said section.

CORPORATE RECORDS

The Certificate of Incorporation and By-Laws, as amended, and the minutes of the annual Stockholders' and monthly Board of Directors' meetings for the five-year examination period were reviewed. Other than those items previously noted in the MANAGEMENT AND CONTROL section, all records appeared to reflect the Company's activities and to provide for its operation in accordance with usual corporate practices and applicable statutes and regulations.

HOLDING COMPANY AND AFFILIATE MATTERS

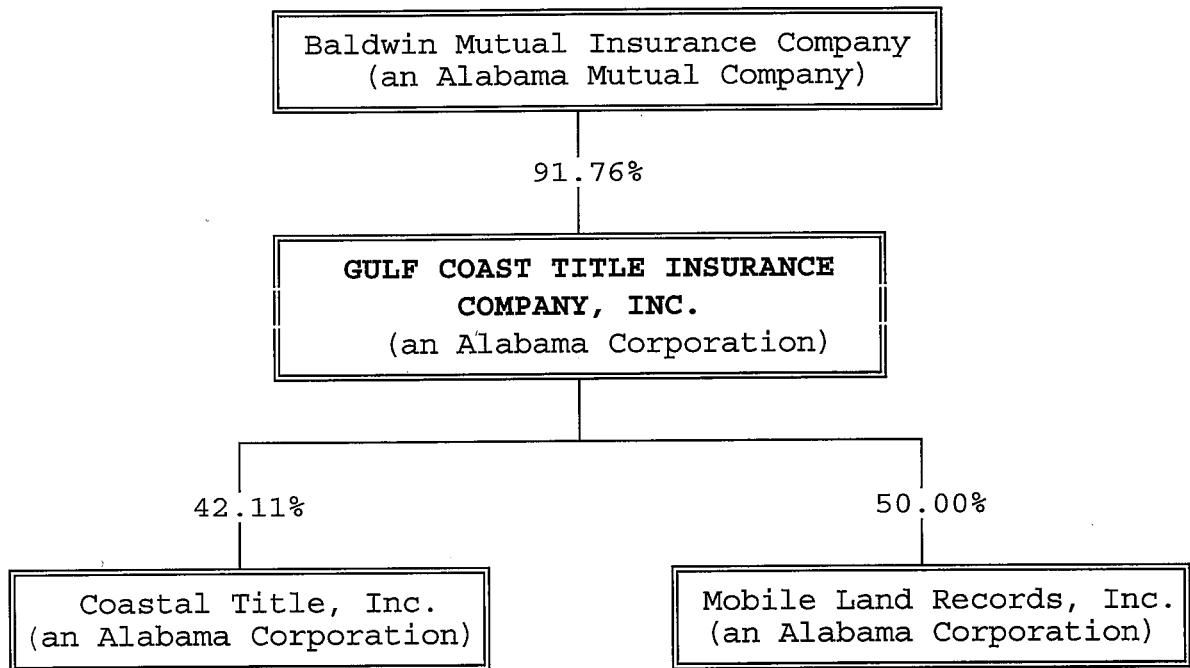
Holding Company Registration

The Company is deemed to be subject to the *Alabama Insurance Holding Company System Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company and its parent, Baldwin Mutual, are registered with the ALDOI as joint registrants of an Insurance Holding Company System.

Appropriate filings required under the Holding Company Act were made from time to time by the Company, as joint registrant. A review of the Company's filings for the five-year period under examination indicated that all required disclosures were included, with the exception of those items discussed later in this section under the caption "Transactions and Agreements with Affiliates."

Organizational Chart

The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2002:



Transactions and Agreements with Affiliates

The examination as of December 31, 1997, noted that several cost sharing, management, service or rental arrangements, for which no written agreements existed, were in effect during the period of examination. Certain unwritten arrangements with the parent and/or affiliated companies included but were not limited to, the following:

- the rental of office space from parent and/or affiliated companies;
- federal income tax allocation;
- personnel management, administrative, and accounting services; and
- the use of certain computer data processing equipment.

During the current examination period, the Company reduced its arrangements to writing and submitted the agreements to the ALDOI for approval by the Commissioner in accordance with ALA. CODE § 27-29-5(b) (1975), which states:

"...transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period."

The Company's files and those of the ALDOI did not contain evidence that the agreements had been approved. Company management indicated that, in accordance with the aforementioned section of the *Alabama Insurance Code*, the agreements were deemed approved after 30 days of submission to the Commissioner.

Unless otherwise stated, the following summarized agreements were in effect at December 31, 2002:

A. Lease Agreements:

(1) At the examination date, the Company had an agreement with its parent, Baldwin Mutual, to rent 449 square feet in the home office building located at 315 E. Laurel Avenue, Foley, Alabama. The Company agreed to pay Baldwin Mutual \$3,592 annual rent, payable at \$299.33 "on or before the first day of each month thereafter, during the continuance of this lease."

The lease stipulated that the Company had the "option to renew for an additional one year period on the same terms and conditions" provided that sixty days' notice was given "in advance of the expiration of the initial term hereof of its intention to so renew."

(2) The Company owned a two story office building located in Foley, Alabama. Office space of approximately 3,000 square feet was leased to Coastal Title, Inc., a partially-owned subsidiary. Annual rent was \$9,000, payable at \$750 monthly.

Both of the above mentioned leases were written and renewed annually on January 1st throughout the five-year examination period.

It was noted that Company records indicated that income in the amount of \$4,200 for rent and \$18,000 for computer services was received in 2002 from the affiliated Baldwin Land Records, Inc. This information was not reported on Annual Statement *Schedule Y – Part 2*.

B. Electronic Data Processing (EDP) Equipment Arrangements:

(1) The Company owned the EDP system and equipment used by its parent in accordance with "a cost sharing arrangement." In 2002, Baldwin Mutual paid the Company more than ninety thousand dollars in computer and microfilm fees. Concerning these arrangements, the Company provided two single page statements, both dated January 2, 2001, disclosing the following information:

"The following services are provided by Gulf Coast Title Insurance Company for Baldwin Mutual Insurance Company: Computer Processing, Management, Software, Hardware, Maintenance and use of Mobile and Baldwin County land records, at the rate of \$7,120.39 per month."

"Gulf Coast Title Insurance Company provides microfilming services for Baldwin Mutual Insurance Company at the rate of \$500.00 per month."

(2) The Company owned other EDP equipment located in the respective offices of Coastal Title, Inc., and Mobile Land Records, Inc., partially owned subsidiaries of the Company, and Baldwin Land Records, Inc., a title plant 50 percent owned by the Company. The Company provided a one page statement, dated January 2, 2001, which stated the following:

"Gulf Coast Title Insurance Company provides Computer Processing and Hardware for Mobile Land Records, Inc. at the rate of \$1,500.00 per month."

C. Tax Allocation Agreement:

NOTE 9, item D of the Annual Statement's *Notes to Financial Statements* reported that a consolidated income tax return was filed with Baldwin Mutual. The following information was disclosed in the Form B filings under Item 5(h):

"A consolidated income tax return is filed with the Company's majority-owned subsidiary, Gulf Coast Title Insurance Company, Incorporated. The method of allocation between the companies is subject to a written agreement approved by the Board of Directors. Allocation is based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually in the first quarter."

Baldwin Mutual provided a copy of a resolution from its Board of Directors, dated February 23, 1989, which specified "that the total tax liability of the group is allocated on a pro-rata basis, based on the taxable income of each company in relation to the total taxable income of the group." Management provided a one page *Tax Agreement*,

which was not dated, stating the following:

"Pursuant to Board of Director's resolution, the above referenced companies agree to the following tax allocation:

The Fedral [sic] income tax liability of Gulf Coast Title Insurance Company, Incorporated is to be calculated on the basis of a stand alone company. Baldwin Mutual Insurance Company's income tax liability is calculated at the maximum marginal rate in effect for the consolidated companies, with Gulf Coast Title Insurance Company, Incorporated receiving the benefit of the tax brackets."

D. Accounting, Management, Operating and Service Arrangements:

Because the Company had no employees, all services were performed on a contractual basis. There was no specific arrangement related to services performed by the Company's parent, although management indicated that several functions were performed by a Baldwin Mutual employee. Various accounting functions, including the formulation of financial statements and reports, and the convention blanks, were prepared by a CPA. No written agreements were provided that detailed specific performances, tasks, fees or remuneration.

The Company provided a one page statement, dated January 2, 2001, which stated the following concerning the provision of accounting services to the affiliated Coastal Title, Inc.:

"Gulf Coast Title Insurance Company provides monthly accounting services for Coastal Title, Inc. at the rate of \$75.00."

Without employees, it is unknown how the Company provides these services.

As was noted in the previous examination, the examiners were unable to determine that the benefits to the Company derived from the various operating, management and service agreements were fair and reasonable in accordance with ALA. CODE § 27-29-5(a)(1) (1975). The Company had still not performed any analysis to determine that the services being provided (which included but were not limited to accounting, administrative and data processing services) were fair and reasonable in comparison to what a comparable outside service would cost the Company.

Item (4) of the aforementioned section of the *Alabama Insurance Code* states that:

"The books, accounts and records of each party will be so maintained as to clearly and accurately disclose the precise nature and details of the transactions."

ALA. CODE § 27-29-5(b) (1975) states, in pertinent part, that:

“...transactions involving a domestic insurer and any person in it holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such a transaction at least 30 days prior thereto...and the commissioner has not disapproved it...”

SSAP No. 25, of the NAIC's Accounting Practices and Procedures Manual (Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties) also requires that transactions between affiliates meet fairness and reasonableness standards, and fees for services performed by such an affiliate should be at arm's length and reasonable. The Company could not provide any cost and services received analyses with regards to the services performed for the various companies; consequently, the examiners could not determine if the fees charged were equitable to both the parties.

In addition, ALA. CODE § 27-27-29(a) (1975), requires that the Company maintain “...complete records of its assets, transactions and affairs.”

Because several of the arrangements with affiliated companies were not detailed, the specifics of various transactions could not be determined by this examination. ALA. CODE § 27-29-4(b)(3) (1975), requires that information about the agreements in force between an insurer and its affiliates be made current in the filing of the Form B Amendment Registration Statement. The agreements discussed in items A, B and C, above, were appropriately disclosed in the 2002 filing.

Dividends to Stockholders

The following exhibit indicates the cash dividends paid to stockholders during the current examination period:

<u>YEAR PAID</u>	<u>RATE PER SHARE</u>	<u>AMOUNT PAID</u>
1998	\$2.00	\$19,910
1999	\$2.00	19,910
2000	\$2.00	19,910
2001	\$2.00	19,910
2002	\$2.00	19,910

The declaration of these dividends was reported to the ALDOI in accordance with ALA. CODE § 27-29-4(d) (1975).

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2002, the Company was a named insured under a Financial Institution Bond, issued by Traveler's Casualty and Surety Company of America. The single loss limit liability of the bond was \$500,000, with a single loss deductible of \$20,000, which exceeded the minimum requirements for fidelity coverage, as defined by NAIC guidelines.

During the period under examination, the Company was included as an additional named insured on the following policies with its parent, Baldwin Mutual:

- Professional Liability
- Directors and Officers Liability
- Property Fire and Hazard
- Commercial Automobile
- Executive Life.

During the review of *Real estate*, it was determined that one property did not maintain a current appraisal; consequently, the property was not admitted for the purpose of statutory reporting. [A detailed discussion of this matter may be found later in this report, under the "Note 2 - Real estate" caption in the NOTES TO FINANCIAL STATEMENTS section.] Based on a \$100,000 appraised valuation, and the \$85,800 reported Annual Statement value, the \$50,000 coverage was not adequate. However, because the appraisal was not deemed reliable, the adequacy of the coverage could not be determined for the purposes of this examination.

Other than the above mentioned discrepancy, the insurance coverages and limits carried by the Company appeared to adequately protect the Company's interests at the December 31, 2002 examination date.

EMPLOYEE AND AGENT WELFARE

The Company had no employees at December 31, 2002, and no employee benefit plans

were in effect. All services to the Company were performed on a contractual basis.

During the review of the minutes for the Company's Board of Directors meetings, it was noted that there were several references to bonuses and percentage increases for "deserving employees." No determination could be made as to the identity of these persons or why the Board authorized salary increases when there were no employees.

It was noted that a management agreement with the Company's President (formerly the Executive Vice President) has been in effect since March 17, 1980. A detailed discussion of this contract may be found beginning on page 5 in the "MANAGEMENT AND CONTROL" section of this examination report under the caption "Management Contract."

SPECIAL DEPOSITS

In compliance with statutory requirements, the Company maintained the following security on deposit with the Alabama State Treasurer at December 31, 2002:

<u>DESCRIPTION</u>	<u>PAR VALUE</u>	<u>STATEMENT VALUE</u>	<u>MARKET VALUE</u>
Colonial Bank, Foley, Alabama, Certificate of Deposit, 3.00%, (Auto renewal)	<u>\$100,000</u>	<u>\$100,000</u>	<u>\$100,000</u>

This deposit was verified in writing by the ALDOI.

MARKET CONDUCT ACTIVITIES

Territory

At the examination date, the Company was licensed to transact title insurance business in the state of Alabama. The Certificate of Authority was inspected for the five-year period under review, and no exceptions were noted.

No licenses applications were pending at December 31, 2002, and at the date of this report.

Plan of Operation

During the examination period, the Company wrote only title insurance in the State of Alabama. Coastal Title, Inc., and Mobile Land Records, Inc., were the Company's two active licensed agents at December 31, 2002.

Title Insurance Company and Agent Operations/Management

The Annual Statements for the five-year examination period were reviewed to determine if the Company was licensed only in the states in which it was writing business. During that time, the Company was licensed only in the State of Alabama to write title insurance, per *Schedule T* of the Annual Statements.

Management stated that the Company had a central recovery and backup procedures for protecting the integrity of its records. At the examination date, there were no written procedures for the recovery/backup plan, or accompanying procedure manuals, to define the methods for protecting the records, whether electronic or not, which are maintained offsite and would be used to start operations anew.

TITLE INSURANCE COMPANY AND AGENT OPERATIONS/MANAGEMENT
Standard 3 – The Company has antifraud initiatives in place that are reasonably calculated to detect, prosecute, and prevent fraudulent insurance acts.

Antifraud Plan and Implementation

The Company did not have any initiatives in place to:

- detect, prosecute and prevent fraudulent insurance acts, per guidelines by Title Insurance Company and Agent Operations/Management Standard 3 of the NAIC's Market Conduct Examiners Handbook; or
- prevent persons convicted of a felony involving dishonesty or breach of trust from participating in the business of insurance pursuant to the Violent Crime Control and Law Enforcement Act of 1994, Public Law 103-322, H.R. 3355; 18 U.S. Code §§ 1033-1034.

ALA. ADMIN. CODE 482-1-121 (2003) provides ALDOI procedures governing persons who are subject to U.S. Code § 1033. Management indicated that the Company relies on an employment agency to screen prospective employees, and retains an attorney to insure that current employees are in compliance with the laws. No specific procedures were provided in reference to detecting convictions of any criminal felony involving dishonesty, breach of trust, etc.

Complaint Handling

Neither the Consumer Division of the ALDOI nor the Company had any recorded complaints against the Company for the examination period of January 1, 1998 – December 31, 2002.

COMPLAINT HANDLING Standard 2 - There are adequate complaint handling procedures in place.

Complaint procedures

The Company did not have procedures in place for the handling of complaints as defined in Complaint Handling Standard 2 of the NAIC's Market Conduct Examiners Handbook. There are no statutes governing complaint procedures; however, the NAIC does specify that the Company should have procedures in place to provide an adequate method for the handling of complaints and for the communication by the Company to consumers. Written procedures would ensure that the Company was consistently recording and responding to consumer direct complaints and those from the ALDOI.

Escrow, Settlement, Closing, or Security Deposit Funds

The Company did not conduct any mortgage closings. There were no escrow, settlement, closing or security deposit accounts held by the Company during the examination period. The mortgage closing and accounts were held by the title agents licensed and appointed by the Company, and these agents conducted the daily operations necessary for the title insurance business.

Marketing and Sales

The Company currently markets title insurance in the state of Alabama. Business is written through the Company's title agents. The premiums are collected by the title agents at the time of mortgage closings.

The Company had no formal advertising program and did not do any advertising during the examination period. There were no materials from the Company or agent sales materials to be reviewed. The agents used the Mississippi Valley Title Insurance Company (MVTIC) Agents Manual. Management indicated that the MVTIC Agents Manual was used since the Company and MVTIC were doing business together and

in order to minimize costs. The manual was reviewed for any references to unfair discrimination tactics or avoidance of statutory compliance, and none were noted.

Title Insurance Agent Relations

An inspection of the Company's records was conducted to determine if agents representing the Company were properly licensed and appointed by the State of Alabama. The Company had not appointed any new agents during the five-year examination period. The two agents writing business were properly appointed prior to writing business on behalf of the Company in accordance with ALA. CODE §§ 27-7-4(a), and 27-7-30(a) (1975). The Company did not have any terminated title insurance agents during the period under review.

The Company approved an "Agents Manual" that includes underwriting guidelines, which are a portion of requirements of Title Insurance Agent Relations Standard 3 of the NAIC's Market Conduct Examiners Handbook. This manual was provided by MVTIC and has been used by the Company since August 7, 1980, at which time an agreement was signed between MVTIC and the Company.

The Company does not have title insurance agent accounts current. The title agent that performs the mortgage closings reports premiums to the Company on a monthly policy register.

TITLE INSURANCE AGENT RELATIONS Standard 1 – The title insurance agents are properly licensed and appointed (if required by state law) in the jurisdiction where the application is taken.

Agents' Licenses – Maintenance of records

The Company did not keep copies of the licenses of its title agents in accordance with ALA. CODE § 27-27-29 (1975), which requires the insurer to keep complete records of its transactions and affairs.

Title Agents' Certificates of Authority

The ALDOI Bulletin, dated July 12, 2001 [*The Alabama Title Insurance Act ALA. Act No. 2001-496*, added, 2001-7, *Title Agent Licensing*], and effective October 1, 2001, requires that all title insurers obtain a certificate of authority for each agent. The Company did not have these certificates for its title agents.

TITLE INSURANCE AGENT RELATIONS Standard 3 – Written underwriting contracts, which include required provisions, are in place between title insurance agencies and all applicable title companies and business is not placed without a contract.

Written contracts between the Company and affiliates

During the examination period, there were no written contracts between the Company and the title agents, both affiliates. Title Insurance Agent Relations Standard 3 of the NAIC's Market Conduct Examiners Handbook stipulates that written underwriting contracts should set forth the responsibilities of each party. ALA. CODE § 27-29-5 (1975), defines standards for transactions with affiliates or persons within a holding company system. Item (b) of said section, states, in pertinent part:

“...transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such a transaction at least 30 days prior thereto...and the commissioner has not disapproved it within that period.”

Underwriting and Rating

A sample of 50 policies was selected from a population of 551 title insurance policies written during the examination period. The policy files, with any supporting documentation, were reviewed to determine if the rates charged for the policy coverage were in accordance with rates filed with the ALDOI, and if file documentation adequately supported underwriting decisions made.

The rates used were the premium rates for title insurance in the State of Alabama for MVTIC, filed with the ALDOI, effective October 1, 2001, in accordance with ALA. ADMIN CODE 482-1-123 (2001), which states that the rates should be filed prior to use. The filed rates were used to calculate the premiums on the policies reviewed and verified to be in accordance with the rates in the Company's agents' manual. The Company did not bill for title insurance premiums. These premiums were collected at the time of mortgage closings, which were conducted by the title agents. The licensed and appointed title agents for the Company issue the title policies. These policies are inventoried by the title agents and a monthly report, entitled "Monthly Policy Register," is submitted to the Company. *The Settlement Statement*, form HUD-1, which contains information regarding fees, is maintained at the title agent's office.

There was no commission schedule, but the Company paid the title agent 60 percent of the premium, with the remaining 40 percent divided equally between the Company and MVTIC.

The Company indicated that MVTIC's manual, entitled "Mississippi Valley Title Insurance Company Agents Manual," was utilized for underwriting guidelines. Each policy in the above mentioned sample was reviewed for compliance with the Company's underwriting guidelines. There are no specific laws that require the Company to file its underwriting guidelines for title insurance with the ALDOI.

Commission Schedule Agreement

The review of the policies written by the Company determined that there was no written commission schedule agreement between the Company and its title agents, both of which were affiliates. ALA. CODE § 27-29-5 (1975) requires that "...the books, accounts and records of each party will be so maintained as to clearly and accurately disclose the precise nature and details of the transactions." This code section also states that the insurer should notify "the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto..."

UNDERWRITING & RATING Standard 6 - All forms and endorsements forming a part of the contract are identified and filed with the department of insurance (if applicable).

Rates and forms filings

A review of rates and forms utilized by the Company during the examination period was conducted in order to determine compliance with State rules, statutes and regulations concerning filing requirements, and Underwriting & Rating Standard 6, of the NAIC's Market Conduct Examiners Handbook. The Company's President stated that the Company used American Land Title Association (ALTA) policy forms and endorsements, and some of MVTIC's rate filings. ALTA forms were not filed with and approved by the ALDOI. Although MVTIC rates were filed and approved by the ALDOI, the filings did not evidence that they had been made by or on behalf of the Company. The Company is responsible for requiring MVTIC to file an authorization form with its filing, or by completing what is commonly known as a "Me Too Filing," either one of which would include the Company in the filing. By not appropriately filing its forms and rates for approval by the Commissioner, the Company is not in compliance with:

- ALA. CODE § 27-14-8 (1975), which states that the policy can not be issued unless the form has been filed with and approved by the Commissioner; and

- ALA. ADMIN. CODE 482-1-123 (2001) *Rates and Forms Filing Requirements for Property and Casualty Insurance*, which requires that rates, rating manual, supporting information and policy forms to be submitted to the ALDOI and formerly approved prior to their use.

ALA. CODE § 27-13-67 (1975) requires an insurer to file with the ALDOI a copy of the rating plan upon which a rate is based or by which a rate is fixed or determined, before using or applying any rate to any kind of insurance. The filing may be made on behalf of such insurer by a rating organization of which such insurer is a member or subscriber.

Claims

At December 31, 2002, there were no Alabama statutes, regulations or bulletins concerning standards for the investigation and settlement of title claims. ALA. ADMIN. CODE 482-1-125 (2003), which had not been adopted at the examination date, was used as a guideline in the review of claims for the purposes of this examination. This regulation, effective May 21, 2003, sets forth minimum standard for the investigation and disposition of property and casualty claims. Section .04, captioned *File and Record Documentation*, defines the maintenance of claims files so that data is accessible and retrievable for examination purposes. The administrative code also states that "an insurer shall be able to provide the claim number, line of coverage, date of loss, and date and amount of payment."

There were two claims closed during the five-year examination period. Both were litigated and were reviewed for adherence with the previously mentioned ALA. ADMIN. CODE 482-1-125 (2003). The Company paid one of the claims within the time frame as defined in item .07, of that regulation, which states that "within thirty (30) days...the first party claimant shall be advised of the status of acceptance or denial of the claim by the insurer." The other claim was settled in court with no claim liability for the Company.

There were no denied claims during the period, and no open claims at year-end 2002. The claims reviewed indicated that the Company resolved and paid claims in a timely manner. The President of the Company supervised all claims processing.

Claims Handling Procedures

All claims are handled by the MVTIC Claims Manager. The MVTIC manual utilized by the Company did not evidence standards or procedures for the handling of title

claims. There are no Alabama statutes that require a manual for claims handling; however, ALA. CODE § 27-27-29(a) (1975), states that an insurer shall have "...methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Subsequent to the examination date, the ALDOI adopted ALA. ADMIN. CODE 482-1-125 (2003), the purpose of which was to set forth minimum standards for the investigation and disposition of property and casualty (P&C) claims. Item .04(c)2., of that regulation, concerning file and record documentation, states:

"The records shall be maintained according to procedures developed and adhered to by the insurer. The procedures shall be made available to the commissioner during an examination."

In light of said regulation, the Company should, henceforth, conduct its claims handling in accordance with those guidelines, and in accordance with claim standards promulgated by the NAIC's Market Conduct Examiners Handbook NAIC.

Privacy Policies and Procedures

[Compliance with ALA. ADMIN. CODE 482-1-122 (2002), formerly known as ALDOI *Regulation No. 122*.]

The Company's Notice of Privacy Policy, Form 121, which was first sent as a mass mailing to all Company policyholders on May 30, 2001, was reviewed for compliance to ALA. ADMIN. CODE 482-1-122 (2002). The Company sends the notice to new business policyholders, when a policy is rewritten or renewed, and annually thereafter.

The privacy form contained *Our Privacy Principles*, which emphasized and explained the Company's policies. These principles appeared to follow the guidelines established in ALA. ADMIN. CODE 482-1-122-.07 (2002), *Information to be included in privacy notices*.

<p><i>TITLE INSURANCE COMPANY AND AGENT OPERATIONS/MANAGEMENT</i> <i>Standard 15 – The company has policies and procedures to protect the privacy of nonpublic personal information relating to its customers, former customers and consumers that are not customers.</i></p>

Procedures to Limit Access to Personal Information

During the review of the Company's Notice of Privacy Policy form, it was noted that the Company did not have procedures for the collection, use and disclosure of

information to limit access to this personal information as defined by Standard 15 of the Title Insurance Agent Operations/Management section of the NAIC's Market Conduct Examiners Handbook. Without specific procedures, the Company could not evidence that improper intrusion into the privacy of its applicants and policyholders was minimized.

The Company does inform consumers of what information is shared, why it is shared, and with whom it is shared.

Opt Out Method for Disclosure of Nonpublic Personal Financial Information

A review of the privacy policy form provided by the Company indicated that a reasonable means to opt out of disclosure of nonpublic personal financial information had not been provided. ALA. ADMIN CODE 482-1-122-.08 (2001), A.(2)(b)(iv), *Form of Opt Out to Consumers and Opt Out Methods*, requires the licensee to provide a reasonable means to exercise an opt out, if it does any of the following:

- “(i) Designates check-off boxes in a prominent position on the relevant forms with the opt out notice.
- (ii) Includes a reply form together with the opt out notice.
- (iii) Provides an electronic means to opt out, such as a form that can be sent via electronic mail or a process at the licensee's web site, if the consumer agrees to the electronic delivery of information.
- (iv) Provides a toll-free telephone number that consumers may call to opt out.”

The Company listed a telephone number on the Notice of Privacy Policy that consumers may call to request that information not be shared; however, the number was not toll-free, as required in item (iv) of the above mentioned regulation code. The burden of the call would be on the consumer.

The Company did not have any joint marketing that would require the sharing of nonpublic personal financial information. *Our Privacy Principles* in the Notice of Privacy Policy, stated that the Company does not disclose consumer information to any nonaffiliated third party.

The Company does not disclose nonpublic personal health or medical information.

FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

	<u>*2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>*1997</u>
Admitted assets	\$610,311	\$784,839	\$796,802	\$799,883	\$828,916	\$833,147
Liabilities	216,962	222,046	223,200	236,058	249,369	251,784
Common capital stock	200,000	200,000	200,000	200,000	200,000	200,000
Gross paid in and contributed surplus	572,537	572,537	572,537	572,537	572,537	572,537
Unassigned funds (surplus)	(376,764)	(207,320)	(196,511)	(206,288)	(190,566)	(188,750)
Treasury stock	2,424	2,424	2,424	2,424	2,424	2,424
Premiums earned	32,412	38,654	50,153	48,972	45,804	38,541
Losses incurred	(2,937)	(2,937)	(2,937)	(2,937)	(2,937)	2,509

*Per Examination

REINSURANCE

Reinsurance Assumed

The Company did not assume any business as reinsurance during the five-year examination period, and no contracts for assumed reinsurance were in effect at December 31, 2002.

Reinsurance Ceded

The Company ceded reinsurance to Mississippi Valley Title Insurance Company (MVTIC) during the examination period. Two contracts were in force, although the Company's President indicated that only the *Coinurance/ Reinsurance Agreement* was utilized during this time. The treaties and amendments were reviewed with regard to type, limits and pertinent safeguards. The following contracts were applicable to December 31, 2002:

REINSURANCE AGREEMENT

(Liability, Non-proportional - Excess of loss)

Reinsurer: Mississippi Valley Title Insurance Company, Jackson, MS

An agreement between the Company and MVTIC, dated January 17, 1980, provided that MVTIC would reinsure all policies of title insurance issued by the Company to the effective date of the agreement in excess of \$50,000, by way of assuming all liability on those policies in excess of \$50,000. The Company agreed to notify MVTIC prior to the issuance of any binder, commitment, or preliminary title policy in excess of \$250,000.

Limits: The agreement was subject to a maximum face amount of \$250,000, and contained the following provision:

“If MISSISSIPPI determines to secure additional reinsurance from other title insurance companies on such large transactions, it shall do so and GULF COAST shall pay MISSISSIPPI for only \$250,000 of reinsurance; the cost of any additional reinsurance needed shall be paid by GULF COAST to such reinsurers at a rate not exceeding then existing reinsurance rates being charged in N.T.U.A Facultative reinsurance transactions.”

Amendment: The agreement was amended on August 7, 1980, whereby all premium income and all liabilities were divided equally between MVTIC and the Company on policies issued by Coastal Title, Inc., up to a face value of \$250,000. Above that, the reinsurance would be picked up jointly by MVTIC and Title Insurance Company of Minnesota; and after payment of commission, those companies would be entitled to the premium income.

Termination: The agreement may be terminated by either party by giving 180 days written notice to the other party.

The President of the Company stated that this agreement was no longer being used and was superceded by the 1983 *Coinurance/Reinsurance Agreement* with MVTIC. There was no written termination documentation.

COINSURANCE/REINSURANCE AGREEMENT

(Liability, Pro-rata)

Reinsurer: Mississippi Valley Title Insurance Company, Jackson, MS

The agreement between the Company and MVTIC provided coinsurance on an equal share (50/50) basis for all business insuring titles to real property and the lien, validity and priority of mortgages or other security instruments encumbering real property.

Limits: This agreement was subject to a maximum face amount of \$250,000. In addition, the agreement provided that MVTIC would assume 100 percent of the liability in excess of \$250,000. This agreement was applicable to business produced by certain agents specified in the contract.

Amendments:

Amendment I: February 12, 1985. MVTIC agreed that all reinsurance made, ceded, renewed or otherwise becoming effective (under this treaty) after September 1, 1952, would be payable by MVTIC on the basis of the liability of the ceding insurer under the contract or contracts reinsured.

Amendment II: April 24, 1985. MVTIC agreed to (1) reinsure all title policies issued by the Company subsequent to the effective date of the agreement in excess of \$250,000, by way of assuming all liability on those policies in excess of \$250,000; and (2) be solely liable for any loss or aggregate of losses in excess of \$250,000 on all policies issued by the Company that are reinsured by MVTIC. In addition, MVTIC will indemnify the Company for any loss or liability the Company may sustain in excess of \$250,000.

Termination: The agreement may be terminated by either party by giving 30 days written notice to the other party.

It was noted that neither agreement contained arbitration, intermediary, or Errors and Omissions clauses.

Insolvency clause

It was noted that the *Reinsurance Agreement* of January 17, 1980, did not contain an insolvency clause. Although that agreement was not utilized during the examination period, the contract had not been terminated; therefore, the Company was not in compliance with item (a.) of paragraph 8, of *SSAP No. 62*, of the NAIC's Accounting Practices and Procedures Manual, which states that "[t]he agreement must contain an acceptable insolvency clause..."

Maximum coverage by reinsurer

The *Reinsurance Agreement* between the Company and MVTIC, dated January 17, 1980, contained maximum reinsurance coverage information. Company officials were unsure if the contract had been terminated, but that the *Coinsurance/Reinsurance Agreement*, dated September 1, 1983, superceded the other. The maximum reinsurance coverage in the ceding program was not stated in the newer contract.

ACCOUNTS AND RECORDS

Accounting System

The Company's accounting records were maintained both manually and by computer. The certified public accounting (CPA) firm of Taylor, Leaser & Elder, P.C., (formerly known as S.F. Parker and Company, P.C.), Foley, Alabama, supervised the accounting operations, prepared monthly financial statements, and was primarily responsible for the preparation of the Company's Quarterly and Annual Statements.

In accordance with Section 1.B., of ALDOI *Regulation No. 100*, the Company was exempt from filing audited financial reports. The Company elected to be audited annually during the five-year examination period by the above mentioned CPA firm. CPA workpapers were made available for review and were tested and utilized in this examination to the extent deemed necessary.

The Company qualified for the small company exemption from filing a *Statement of Actuarial Opinion* throughout the examination period. The Company requested such an exemption from the ALDOI for each of the years in the examination period, and a certified copy of the approved exemption was filed with the Annual Statements in accordance with instructions thereto.

Accounting Practices and Changes

The ALDOI recognizes only statutory accounting practices permitted by the State of Alabama for determining and reporting the financial condition and results of operations of an insurance company, thereby determining its solvency under the *Alabama Insurance Code*. When submitting financial reports to the ALDOI, all insurers are required to use the NAIC Annual Statement Convention Blank prepared in accordance with instructions thereto. Accounting practices and procedures prescribed by the NAIC's Accounting Practices and Procedures Manual are followed except when in conflict with Alabama

statutes or other ALDOI rules, regulations or guidelines.

Effective January 1, 2001, the State of Alabama required that Alabama-domiciled insurance companies prepare their statutory basis financial statements in accordance with the Statements of Statutory Accounting Principles (SSAPs) of the NAIC's Accounting Practices and Procedures Manual, subject to any deviations advocated or permitted by the Insurance Commissioner of the ALDOI (Codification). The purpose of Codification of statutory accounting principles is to produce a consistent, comprehensive, and comparable basis of accounting and reporting for use by insurance departments, insurers and auditors.

Accounting Records

It was noted that, during the five-year examination period, the Company did not maintain complete electronic data backups as of year-end. Many of the samples utilized during the examination could have been selected electronically with the examiners' audit software had the information been maintained in electronically compatible format. Consequently, numerous samples had to be selected manually thereby delaying the completion of the examination.

Section 3, of ALDOI *Regulation No. 118*, requires that:

"Every insurer... shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years."

Section 4, of said regulation stipulates that "records in a computer-based format shall be archival in nature only, so as to preclude the possibility of alteration of the contents of the record by computer after the initial transfer of the record to this format..."

Because the Company maintains the majority of its information in electronic format, backup files should be maintained in order to readily reproduce said records for examination purposes. When this matter was brought to the Company's attention, management indicated that henceforth, electronic backups would be created, as of the Annual Statement date, and stored for the prescribed periods in accordance with the particular regulatory authorities.

Detailed discussions and additional commentary on these matters may be found in

the NOTES TO FINANCIAL STATEMENTS and COMMENTS AND RECOMMENDATIONS sections of this examination report, under the captions to which they pertain.

In general, the accounting records appeared to reflect the operations during the period under review and the condition of the Company at December 31, 2002.

FINANCIAL STATEMENTS INDEX

The Financial Statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2002. Amounts shown in the comparative statements for the years 1998, 1999, 2000 and 2001, were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

	<u>Page</u>
Statement of Assets, Liabilities, Surplus and Other Funds	29
Statement of Income	31
Capital and Surplus Account	32

**FAILURE OF FINANCIAL STATEMENTS TO BALANCE TO INDICATED TOTALS
IS DUE TO ROUNDING.**

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART
THEREOF.**

GULF COAST TITLE INSURANCE COMPANY, INC.
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
For the Year Ended December 31, 2002

	<u>Current Year Assets</u>	<u>CY Non- admitted Assets</u>	<u>CY Net Admitted Assets</u>	<u>PY Net Admitted Assets</u>
<u>ASSETS</u>				
Preferred stocks	\$ 6072	\$ 0	\$ 6,072	\$ 6,072
Common stocks (Note 1)	120,193	6,573	113,620	125,462
Real estate:				
Properties held for the production of income income (Note 2)	239,473	106,988	132,485	268,495
Cash (\$272,636) and short-term investments (Note 3)	<u>272,636</u>	<u>23,069</u>	<u>249,567</u>	<u>263,770</u>
Subtotals, cash and invested assets	\$ 638,374	\$136,630	\$501,744	\$663,799
Title plants	748,280	648,280	100,000	100,000
Title insurance premiums and fees receivable (Note 4)	0	0	0	
Electronic data processing equipment	8,179		8,179	20,620
Interest, dividends and real estate income due and accrued	388		388	420
Other assets nonadmitted	<u>900</u>	<u>900</u>	<u>0</u>	<u>0</u>
TOTALS	<u>\$1,396,121</u>	<u>\$785,810</u>	<u>\$610,311</u>	<u>\$784,839</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART
THEREOF.

GULF COAST TITLE INSURANCE COMPANY, INC.
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
For the Year Ended December 31, 2002
(-continued-)

<u>LIABILITIES</u>	<u>Current Year</u>	<u>Prior Year</u>
Known claims reserve	\$ 0	\$ 0
Statutory premium reserve	50,043	56,428
Supplemental reserve	95,446	91,096
Other expenses (excluding taxes, licenses and fees) (Note 5)	14,520	14,446
Federal and foreign income taxes (excluding deferred taxes) (Note 6)	21,364	24,838
Aggregate write-ins for other liabilities:		
Reinsurance premiums payable	<u>35,589</u>	<u>35,238</u>
TOTAL LIABILITIES	\$216,962	\$222,046
 <u>CAPITAL AND SURPLUS</u>		
Common capital stock	200,000	200,000
Gross paid in and contributed surplus	572,537	572,537
Unassigned funds (surplus) (Note 7)	(376,764)	(207,320)
Less treasury stock, at cost:	<u>2,424</u>	<u>2,424</u>
Total surplus		
Surplus as regards policyholders	<u>\$393,349</u>	<u>\$562,793</u>
TOTAL LIABILITES, CAPITAL AND SURPLUS	<u>\$610,311</u>	<u>\$784,839</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART
THEREOF.

GULF COAST TITLE INSURANCE COMPANY, INC.
STATEMENT OF INCOME
For the Years Ended December 31, 2002, 2001, 2000, 1999, and 1998

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<u>OPERATING INCOME:</u>					
Title insurance and related income:					
...Title insurance premiums earned					
[\$140,569 (Note 4)]	\$(108,157)	\$ 38,654	\$ 50,153	\$ 48,972	\$ 45,804
Other title fees and service charges					
[\$308 (Note 4)]	6,491	5,370	6,775	9,074	9,566
Aggregate write-ins for other operating income:					
Data processing and other					
[\$250,500 (Note 4)]	(111,484)	139,210	138,892	138,867	133,390
Total Operating Income	<u>\$(213,150)</u>	<u>\$183,234</u>	<u>\$195,820</u>	<u>\$196,913</u>	<u>\$188,760</u>
<u>DEDUCT:</u>					
Losses and loss adjustment expenses					
Incurred	\$ (2,937)	\$ 0	\$ 8,537	\$ 0	\$ 2,310
Operating expenses incurred					
[\$440 (Note 4)]	95,569	103,562	115,216	120,168	112,893
Aggregate write-ins for other operating deductions:					
Investment loss (Note 2)	11,547				
Provision for title losses	4,350	1,608	(6,320)	2,133	(6,651)
Total Operating Deductions	<u>\$ 108,529</u>	<u>\$105,170</u>	<u>\$117,433</u>	<u>\$122,301</u>	<u>\$108,552</u>
Net operating gain or (loss)	<u>\$(321,679)</u>	<u>\$ 78,064</u>	<u>\$ 78,387</u>	<u>\$ 74,612</u>	<u>\$ 80,208</u>
<u>INVESTMENT INCOME:</u>					
Net investment income earned	\$ 20,592	\$ 24,437	\$ 26,190	\$ 25,840	\$ 27,712
Net realized capital gains or (losses)	(7,819)	539	0	310	5,830
Net investment gain or (loss)	<u>\$ 12,773</u>	<u>\$ 24,976</u>	<u>\$ 26,190</u>	<u>\$ 26,150</u>	<u>\$ 33,532</u>
<u>OTHER INCOME:</u>					
Net income before federal income taxes	\$(308,906)	\$103,040	\$ 104,77	\$ 100,762	\$ 113,740
Federal income taxes incurred	21,364	24,838	20,318	19,592	19,826
NET INCOME	<u>\$(330,270)</u>	<u>\$ 78,202</u>	<u>\$ 84,259</u>	<u>\$ 81,170</u>	<u>\$ 93,914</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART
THEREOF.

GULF COAST TITLE INSURANCE COMPANY, INC.
CAPITAL AND SURPLUS ACCOUNT
For the Years Ended December 31, 2002, 2001, 2000, 1999, and 1998

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Surplus as regards policyholders, December 31, prior year	\$ <u>562,793</u>	\$ <u>573,602</u>	\$ <u>563,825</u>	\$ <u>579,547</u>	\$ <u>581,363</u>
GAINS AND (LOSSES) IN SURPLUS:					
Net income	\$(330,270)	\$ 78,202	\$ 84,259	\$ 81,170	\$ 93,914
Net unrealized capital gains or losses	(21,771)	(6,013)	3,564	(20,452)	(12,463)
Change in non- admitted assets	202,507	(63,088)	(58,136)	(56,530)	(63,357)
Dividends to stockholders (cash)	<u>(19,910)</u>	<u>(19,910)</u>	<u>(19,910)</u>	<u>(19,910)</u>	<u>(19,910)</u>
Change in surplus as regards policyholders for the year	\$ <u>(169,444)</u>	\$ <u>(10,809)</u>	\$ <u>9,777</u>	\$ <u>(15,722)</u>	\$ <u>(1,816)</u>
Surplus as regards policyholders, December 31, current year	\$ <u>393,349</u>	\$ <u>562,793</u>	\$ <u>573,602</u>	\$ <u>563,825</u>	\$ <u>579,547</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART
THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Common stocks

\$113,620

The captioned amount is \$6,573 less than the \$120,193 reported by the Company in its *Annual Statement as of December 31, 2002*.

The Company's investment in common stocks consisted of five issues of industrial/miscellaneous stocks totaling \$76,344, and two issues of affiliated stock valued at \$43,849. The examination determined several discrepancies concerning the Company's common stock. The following schedule evidences the individual differences, the details of which are discussed below:

Per Company's 2002 Annual Statement		\$120,193
Add: Reclassified from Cash (see Note 3)	\$ 23,069	
Less: Stocks maintained out-of-state	(23,069)	
SCA valuation difference (SVO)	(5,599)	
Missing stock certificates	____(974)	
Total increase/(decrease)		____(6,573)
Per Examination		<u>\$113,620</u>

A \$23,069 in money market account with E*Trade Securities, LLC, was maintained in Rancho Cordova, CA. ALA. CODE § 27-27-29(b) (1975) states:

“Every domestic insurer shall have, and maintain, its assets in this state...”

Accordingly, the \$23,069 is not admitted for the purposes of this examination.

The Company included the aforementioned \$23,069 in money market funds as “cash” on Annual Statement *Schedule E*. SSAP No. 30, of the NAIC's Accounting Practices and Procedures Manual (*Investments in Common Stock*) requires that certain money market funds that do not meet the requirements of the Securities Valuation Office's Purposes and Procedures Manual of the NAIC should be reported as investments in common stock. The Company should, therefore, report money market funds as common stock in accordance with the aforementioned SSAP.

The certificates for common stocks were held on the Company's premises. A security count indicated that there were a total of 200 shares in two issues of stock that were missing. The total value of these securities was \$974. ALA. CODE § 27-27-29(a) (1975) requires that the Company maintain complete records of its assets, transactions and affairs. The \$974 was not admitted for the purposes of this report.

A review of the filed copy of the Securities Valuation Office's Compliance Certificate indicated that the Company had not maintained a signed copy of the aforementioned certificate for its records in compliance with ALA. CODE § 27-27-29(a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

The Company's records indicated that the Company owned 50 percent of Mobile Land Records Inc., and 42.11 percent of Coastal Title Inc. The cost of investments in those affiliated companies was \$176,305 and \$28,000, respectively. The examination considered that the decline in the fair value of the investments in Mobile Land Records Inc., other than temporary, and the investment in Coastal Title Inc., was considered impaired. The Company reported the cost of the investments in *Schedule D – Part 2 – Section 2*, at the aforementioned actual cost. According to the guidance provided by *SSAP No. 46*, paragraph 17, of the NAIC's Accounting Practices and Procedures Manual, any decline in the fair value of an investment in subsidiaries, controlled, and affiliated (SCA) entities that is other than temporary is written down to the fair value as the new cost basis. However, the Company appropriately reported the decline in the fair value as realized loss in the financial statements.

An annual SUB-2 form for Mobile Land Records, Inc., was filed with the Securities Valuation Office by the CPAs on behalf of the Company. The Company's accounting method of valuation was the market approach, and the value per share was estimated at \$17.11, or \$85,525, for 5,000 shares. The Securities Valuation Office valued the stock at \$15.99 per share, or \$79,926, a difference of \$5,599. The method utilized by the Company for the valuation of the SCA securities was in accordance with *SSAP No. 46*, paragraph 7, of the NAIC's Accounting Practices and Procedures Manual. The \$85,525 reported on *Schedule D – Part 2 – Section 2*, for Mobile Land Records, Inc., will be reduced by the \$5,599 difference to \$79,926 for the purposes of the examination.

A SUB-2 form was not filed for Coastal Title, Inc., which reflected a negative value throughout the examination period and at the examination date. The previous examination noted that the value of this majority-owned subsidiary was determined based on an unaudited financial "compilation," which was "limited to presenting in the form of financial statements and supplementary schedules information that is the representation of management."

It was noted that the previous two examinations have recommended that the Company file annual SUB-2 forms for its SCA companies.

Note 2 – Real estate

\$132,485

The captioned amount is \$118,535 less than the \$251,020 reported by the Company in its 2002 Annual Statement. The following schedule details the amounts not admitted as a result of this examination and each are discussed below.

DESCRIPTION	PER COMPANY	PER EXAMINATION	DIFFERENCE
Heritage Oaks	\$152,295	\$132,485	\$ (19,810)
Prichard lot #63	12,925*	0	(12,925)
Bon Secour	85,800	0	(85,800)
TOTALS	\$251,020	\$132,485	\$(118,535)
*Written off as investment loss	\$ 11,547		\$ 11,547
TOTAL (Per examination)	<u>\$239,473</u>	<u>\$132,485</u>	<u>\$(106,988)</u>

The Company reported the Heritage Oaks property at current market value, based on a 1997 appraisal. The *Schedule of Exempt Assets*, dated August 17, 1993, allowed the Company to carry this property at the market value of \$132,485. Since that time, the Company has been annually increasing, or writing up the value to current market value. At December 31, 2002, the Company recorded the admitted value of the property at a market value of \$152,295. No supporting documentation to evidence this valuation methodology was provided during the course of the examination. Consequently, this examination has determined that the \$152,295 reported value overstated the \$132,485 approved value by \$19,810, and the latter amount has been not admitted for the purposes of the examination.

The adoption of Codification in January of 2001, and the repeal of ALDOI *Regulation No. 18*, in April 2001, established statutory accounting principles for real estate investments. *SSAP No. 40*, paragraph 9, of the NAIC's Accounting Practices and Procedures Manual, requires properties to be carried at depreciated cost less encumbrances. Accordingly, the Company should have carried this property on *Schedule A* of the 2002 Annual Statement at \$103,961 (cost of \$137,664, less depreciation of \$33,703). The examiners have reduced the admitted value of the property to only \$132,485, in this report, per the *Schedule of Admitted Assets*. The examiners recommend that the Company either:

- (1) attempt to obtain a permitted practice from the ALDOI in order to amortize the difference between \$132,485 and \$103,961, over a five-year period, and then carry the property at depreciated cost from that point forward; or
- (2) reduce the property to depreciated cost in its next financial statement filed with the ALDOI.

The value of the Heritage Oaks property is adjusted to \$132,485, which is \$19,810 less than the \$152,295 reported by the Company. The \$19,810 is charged to the income statement.

Lack of Appraisals

In order to determine that properties were valued accurately, real estate appraisals for *Properties held for the production of income* were reviewed. *SSAP No. 40*, paragraph 12, of the NAIC's Accounting Practices and Procedures Manual requires that:

“For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date.”

In addition, ALA. CODE § 27-37-7(b) (1975), states that:

“Other real property held by an insurer shall not be valued at an amount in excess of fair value as determined by recent appraisal. If valuation is based on an appraisal more than three years old, the commissioner may at his discretion call for and require a new appraisal in order to determine fair value.”

Heritage Oaks Property

The property located in Foley was appraised in the year 1997; there was no current appraisal. As was discussed previously in this note, the *Schedule of Exempt Assets*

allowed the Company to carry this property at the market value of \$132,485, at the examination date.

Prichard Property

The Prichard property, reported at \$12,925, included \$1,378 in cost of land, \$9,047 in a building and \$2,500 for demolition cost. The building on the property was demolished and demolition costs were added to the value of the property. *SSAP No. 5*, paragraph 7, of the NAIC's Accounting Practices and Procedures Manual states:

“An estimated loss from loss contingency or the impairment of asset shall be recorded by a charge to operations...”

There was no appraisal for the land. ALA. CODE § 27-37-7(b) (1975) requires valuation based on an appraisal no more than three years old, and *SSAP No. 40*, paragraph 12, of the NAIC's Accounting Practices and Procedures Manual states that the appraisal can be no older than five years. The \$1,378 will not be admitted for the purpose of the examination.

There was no building on the property. In accordance with *SSAP No. 5*, paragraph 7, of the NAIC's Accounting Practices and Procedures Manual (both conditions concerning a loss contingency or asset impairment were met), the remaining \$11,547 (\$9,047 + \$2,500) will be written off through the income statement and not be reported in the balance sheet.

The land in Prichard is adjusted to \$0, which is \$12,925, less than the \$12,925 reported by the Company. The aforementioned \$1,378 will be adjusted against the Company's surplus and \$11,547, will be charged against income.

Bon Secour Property

No appraisal was provided by Company management for this property. In accordance with ALA. CODE § 27-37-7(b) (1975) [appraisal can not be more than three years old] and *SSAP No. 40*, paragraph 12, of the NAIC's Accounting Practices and Procedures Manual [appraisal can not be over five years old], the Company is required to maintain a current appraisal. An “appraisal,” dated February 10, 2004, was provided by Mr. Tim Russell, President. The real estate was valued at \$100,000 for the property and improvements and consisted of a memorandum from the broker/owner of a real estate company, and stated the following:

"As per our telephone conversation today and to confirm our previous conversation of 6 to 8 months ago I am sending you this short memorandum.

As a licensed real estate broker/instructor my opinion of the current market value for the subject Property (including improvements) is \$100,000."

A broker/owner is not a qualified appraiser as defined by ALDOI *Regulation No. 59*. The appraisal was not prepared on an income or current replacement cost basis, and there was no other supporting documentation to evidence the valuation. Consequently, the appraisal is not accepted by the ALDOI, and the \$85,800 reported value of this property will be not admitted for the purposes of this examination because ALA. CODE § 27-37-7 (1975) requires that:

"...real property held by an insurer shall not be valued at an amount in excess of fair value as determined by a recent appraisal. If valuation is based on an appraisal more than three years old, the commissioner may at his discretion call for and require a new appraisal in order to determine fair value."

It was noted that the Company maintained \$50,000 of insurance coverage on this property at December 31, 2002. Based on the above mentioned \$100,000 appraised valuation, and the \$85,800 value reported in the 2002 Annual Statement, the \$50,000 coverage was not considered adequate. However, because the appraisal was not deemed reliable, the adequacy of the coverage could not be determined for the purposes of this examination. Additional information on this matter may be found in the FIDELITY BOND AND OTHER INSURANCE section, earlier in this report.

Rental Income

Rental income in the amount of \$750, was received in December 2002, from Coastal Title, Inc., for the following month. However, the income was not reported as income received in advance. The advance rent received by the Company meets the criterion listed in *SSAP No. 5*, of the NAIC's Accounting Practices and Procedure Manual (Liabilities, Contingencies and Impairments of Assets) and should be reported under *Aggregate write-ins for other liabilities* in accordance with the NAIC's Annual Statement Instructions.

Note 3 – Cash and short-term investments

\$249,567

The captioned amount is \$23,069 less than the \$272,636 reported by the Company in its *Annual Statement as of December 31, 2002*.

The Company included \$23,069 in a money market account with E*Trade Securities LLC, Rancho Cordova, CA, as *Cash and short-term investments*. The Security Valuation Office's Purposes and Procedures Manual of the NAIC, and *SSAP No. 30*, paragraph 3(d), of the NAIC's Accounting Practices and Procedures Manual require that money market funds that do not qualify under the Security Valuation Office's exempt list be reported as common stock. The Company should have classified the \$23,069 amount as common stock for the purpose of statutory reporting, and included said amount in *Schedule D – Part 2 – Section 2*, in accordance with the NAIC's Annual Statement Instructions.

In addition, the money market account was maintained outside the State of Alabama, which is in violation of ALA. CODE § 27-27-29(b) (1975), which states:

“Every domestic insurer shall have, and maintain, its assets in this state...”

Accordingly, the \$23,069 is reclassified to common stock and not admitted for the purposes of this examination. Additional information on this matter may be found earlier in this section under the “Note 1 – Common stocks” caption.

Note 4 – Title insurance premiums and fees receivable

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The captioned amount is the same as was reported by the Company in its 2002 Annual Statement and as determined by this examination.

At December 31, 2002, the \$391,817 asset consisted of title insurance premiums and fees due to the Company, accounts receivable, miscellaneous deposits, and prepaid premium taxes. The various accounts are shown in the following schedule:

DESCRIPTION	AMOUNT
Accounts receivable from Coastal Title, Inc.	\$140,569
Accounts receivable from Mobile Land Records, Inc.	250,500
Miscellaneous deposits	308
Prepaid premium tax	<u>440</u>
TOTALS	<u>\$391,817</u>

Coastal Title, Inc., is a subsidiary of the Company with ownership of 42.11 percent at the examination date. The Company provides monthly accounting services to this

affiliate. *Schedule D* of the 2002 Annual Statement, indicated that the common stock held by the Company was impaired (see "Note 1 - Common stocks," earlier in this section). The accounts and records provided by the Company evidenced that some portions of the receivables dated back to 1995.

The Company has an arrangement with its 50 percent owned subsidiary, Mobile Land Records, Inc., to provide computer processing and hardware services for a monthly fee. The Company's workpapers indicated that the \$250,500, consisted of fees and other unpaid expenses outstanding since or prior to 1989.

An evaluation of the accounts was made in accordance with *SSAP No. 5* (Liabilities, Loss Contingencies and Impairment of Assets), of the NAIC's Accounting Practices and Procedures Manual. The review determined that it is probable the balances are uncollectible; for this reason, the impaired assets totaling \$391,069, were recorded by a charge to operations for the purposes of this examination in accordance with paragraph 7, of the aforementioned *SSAP*. The \$391,817 was appropriately not admitted by the Company at the examination date. It was noted that the previous examination report recommended that the Company collect any past due premiums and fees receivable, including those accounts due from its affiliates. The Company did not comply with this recommendation.

ALA. CODE § 27-29-5(a) (1975), and *SSAP No. 25*, of the NAIC's Accounting Practices and Procedures Manual (Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties) require that transactions between affiliates meet fairness and reasonableness standards, and fees for services performed by such an affiliate should be at arm's length. The Company could not provide any cost and services received analyses with regards to the services performed for its affiliated companies. As a result, the examiners could not determine if the fees charged were reasonable to both the parties. Secondly, maintaining substantial overdue balances receivable was not equitable to the Company in accordance with the aforementioned regulatory authorities.

A detailed discussion concerning agreements with these companies may be found in the HOLDING COMPANY AND AFFILIATE MATTERS section, under the "Transactions and Agreements with Affiliates" caption, elsewhere in this report.

Note 5 – Other expenses

\$14,520

The captioned liability is the same as reported in the Company's *Annual Statement as of December 31, 2002*, but \$7,900 less than the \$22,420 amount determined by the examination. Due to immateriality, no changes were made to the financial statements in this report.

A review of Company records subsequent to the examination date indicated that \$7,900 in accounting fees was paid in 2003 for expenses as of year-end 2002. *SSAP No. 5*, of the NAIC's Accounting Practices and Procedures Manual, requires that the Company record a liability for expenses when incurred. The NAIC's Annual Statement Instructions also requires that the Company establish adequate accruals for *Other expenses* in its financial statements.

Note 6 – Federal and foreign income taxes

\$21,364

The referenced liability is the same as reported by the Company in its 2002 Annual Statement but \$2,658 less than the \$24,022 amount determined by this examination. The entirety of the difference consisted of the disparity between the estimated tax liability and the actual amount paid subsequent to the examination period. The amount of the difference was not material, and no changes were made to the financial statements in this report.

A *Tax Agreement* with the Company's majority stockholder, Baldwin Mutual, was discussed previously in the HOLDING COMPANY AND AFFILIATE MATTERS section under the caption "Transactions and Agreements with Affiliates." Additional commentary and suggested corrective actions may be found in the COMMENTS AND RECOMMENDATIONS section of this report, beginning on page 8.

The NAIC's Annual Statement Instructions allows that intercompany transactions arising from income tax allocations among companies participating in a consolidated tax return may be recognized provided that certain conditions are met. One such condition is that a written agreement exists; the Company's agreement was not submitted to or approved by the Commissioner of the ALDOI.

Information concerning the consolidated filing was disclosed in the Company's Form B filing and in *NOTE 9*, of the 2002 Annual Statement's *NOTES TO FINANCIAL STATEMENTS*, both of which stated:

“The method of allocation between the companies is subject to written agreement approved by the Board of Directors. Allocation is based on separate return calculation with current credit for net losses. Intercompany tax balances are settled annually in the first quarter.”

During the review of the tax forms, it was noted that the Company issued its \$24,022 payment check to Baldwin Mutual on April 29, 2003, for its portion of the 2002 tax liability, which is not timely in accordance with the aforementioned representations concerning settlement. The consolidated *Tax Agreement* does not specify a timeframe for settlement of the intercompany tax balance.

Note 7 – Unassigned funds (surplus) **\$(376,764)**

Unassigned funds (surplus), as determined by this examination, was \$148,177 less than the \$(228,587) amount reported by the Company in its 2002 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to that developed by this examination:

Unassigned funds (surplus) per Company **\$(228,587)**

Examination increase/(decrease) to assets:

• <u>Note 1</u> – Common stocks	\$ (6,573)
• <u>Note 2</u> – Real estate	(118,535)
• <u>Note 3</u> – Cash and short-term investments	<u>(23,069)</u>
Total increase/(decrease) to assets	<u>\$(148,177)</u>

Examination (increase)/decrease to liabilities:

• None.	<u>0</u>
Total (increase)/decrease to liabilities	<u>\$(0)</u>

Net Increase/(Decrease) **\$(148,177)**

Unassigned funds (surplus) per Examination **\$(376,764)**

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management. The Company's President indicated that no contingent liabilities or pending litigation existed, which would materially affect surplus in the event of an adverse outcome.

A general review of the Company's records and files, including claims, was conducted during the course of the examination. No items were disclosed that would negatively impact the Company's financial statements at the examination date.

It was noted that the examiners requested information on nonpolicy-related and contingent liabilities from the Company's outside attorney. Several inquiries were unanswered, and no response was received prior to the conclusion of this examination.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regard to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the prior recommendations with the exception of the following items:

Management and Control: Board of Directors, and Officers – The previous report recommended that the Company (1) elect its officers in accordance with specifications defined in the Articles of Incorporation and By-Laws. The Company did not comply with this recommendation.

Holding Company and Affiliate Matters: Transactions and Agreement with Affiliates – It was recommended that the Company perform or obtain cost and services received analyses with regard to various management, operating and service agreements in effect with its parent and affiliated companies, to determine that the services received are fair and reasonable in compliance with ALA. CODE § 27-29-5(a)(1) (1975). It was also recommended that any agreement, which is not determined to be fair and reasonable be obtained from outside sources or discontinued, if deemed to be not necessary. The Company did not comply with these recommendations.

It was recommended that the Company obtain written agreements to substantiate the relationships in effect under which the Company provides services and facilities to, or receives services and the use of facilities from, the various affiliated parties in the Holding Company System, and that all prospective agreements should be filed for approval with the ALDOI Commissioner in accordance with ALA. CODE § 27-29-5 (b) (1975). Although the Company did provide one page statements concerning the arrangements, each was not detailed so as "...to clearly and accurately disclose the precise nature and details of the transactions..." in accordance with ALA. CODE § 27-9-5 (1975). Not all of the arrangements were filed with for approval with the Commissioner; therefore, the Company did not comply with these recommendations in their entirety.

It was recommended that the Company include revenues/expenditures, etc., under its existing management agreements, arrangements, service contracts, etc., on *Schedule Y – Part 2*, in accordance with the NAIC's Annual Statement Instructions. The Company reported certain amounts in Column 8 (Management Agreements and Service Contracts); therefore, the Company complied with this recommendation. It was noted, however, that the Company did not include all revenues and expenditures for all its management, services and facilities agreements in this schedule; therefore, the Company did not comply with this recommendation in its entirety.

Accounts and Records – The previous report recommended that the Company: (1) maintain complete set of detailed workpapers used to prepare future Annual Statements so as to be in compliance with ALA. CODE § 27-27-29(a) (1975); and (2) accurately complete its Annual Statement in its entirety in accordance with the NAIC's Annual Statement Instructions and ALDOI *Regulation No. 97*. The Company did not comply with these recommendations.

Common stocks – The previous examination recommended that the Company: (1) file Security Acquisition Reports on all investment acquisitions, including annual SUB-2 forms on its subsidiary companies in accordance with the Security Valuation Office's Purposes and Procedures Manual of the NAIC; and (2) complete *Schedule D* of future Annual Statements in accordance with NAIC instructions thereto. The Company did not comply with these recommendations in their entirety.

Title insurance premiums and fees receivable – It was recommended that the Company collect any past due premiums and fees receivable, including those accounts due from its affiliates. The Company did not comply with this recommendation.

Federal and foreign income taxes – The previous examination report recommended that the Company follow the representations made in its Form B filing and settle all intercompany balances annually in the first quarter of the year.

The Company did not comply with this recommendation.

All of these recommendations are restated in the following COMMENTS AND RECOMMENDATIONS section of this report, under the specific captions to which they pertain.

COMMENTS AND RECOMMENDATIONS

The following summary presents the comments and recommendations that are made in the current *Report of Examination*.

Management and Control:

Board of Directors, and Officers – Pages 4 and 5

It is recommended that the Company elect nine members to its Board of Directors, and fill empty positions in accordance with its By-Laws.

It is recommended that the Company's Board of Directors elect its officers in kind and number in accordance with its By-Laws.

Conflict of Interest – Page 6

It is recommended that conflicts, potential conflicts, and/or related person relationships be disclosed in the Company's annual conflict of interest statements in accordance with ALA. CODE § 10-2B-8.60 (1975).

Holding Company and Affiliate Matters:

Transactions and Agreements with Affiliates – Page 8

It is recommended that the Company perform or obtain cost and services received analyses with regard to various management, operating and service agreements in effect with its affiliated companies, to determine that the services are fair, reasonable and at

arm's length in compliance with ALA. CODE § 27-29-5(a)(1) (1975), and *SSAP No. 25*, of the NAIC's Accounting Practices and Procedures Manual. In addition, it is **recommended** that any agreements which are not determined to be fair and reasonable, be obtained from outside sources or discontinued, if deemed to be not necessary. A similar recommendation was also made in the previous examination report.

It is further recommended that the Company review any future invoices received to determine that the charges are rendered in accordance with the terms and conditions of the agreement(s), and that the disbursement is in compliance with ALA. CODE § 27-27-30 (1975), which requires a voucher and supporting documentation to evidence any disbursement of \$25 or more. This recommendation was also made in the previous examination report.

It is recommended that the Company obtain written agreements to substantiate the relationships in effect under which the Company provides services and facilities to, or received services and the use of facilities from, the various affiliated parties in the Holding Company System. Item (4) of the aforementioned section of the *Alabama Insurance Code* requires that records between the parties be so maintained so as "to clearly and accurately disclose the precise nature and details of the transactions." This recommendation was also made in the previous examination report.

It is recommended that the Company file all current and prospective agreements with affiliated companies in accordance with ALA. CODE § 27-29-5(b) (1975), which requires filing with and approval from the Alabama Insurance Commissioner prior to entering into any such transaction. This recommendation was also made in the previous examination report.

It is recommended that the Company include all information concerning transactions with any affiliate in *Schedule Y – Part 2*, of the Annual Statement in accordance with instructions thereto.

Fidelity Bond and Other Insurance – Page 13

It is recommended that the Company maintain adequate insurance coverage on all of its properties in order to protect its investment in real estate.

Market Conduct Activities – Page 14

Title Insurance Company and Agent Operations/Management – Page 15

Antifraud Plan and Implementation – Page 15

It is recommended that the Company have antifraud initiatives in place to detect, prosecute and prevent fraudulent insurance acts per guidelines detailed by Title Insurance Company and Agent Operations/Management Standard 3 of the NAIC's Market Conduct Examiners Handbook, and in accordance with ALA. ADMIN. CODE 482-1-121 (2003), which provides ALDOI procedures governing persons who are subject to U.S. Code § 1033.

Complaint Handling – Page 16

Complaint procedures – Page 16

It is recommended that the Company establish guidelines for complaint procedures to satisfactorily distribute, record and respond to complaints and communicate this to policyholders as defined by Complaint Handling Standard 2 of the NAIC's Market Conduct Examiners Handbook. Written procedures would ensure that the Company was consistently recording and responding to consumer direct complaints and those coming from the ALDOI.

Title Insurance Agent Relations – Page 17

Agents' Licenses – Maintenance of records – Page 17

It is recommended that the Company keep copies of all licenses for its title agents in accordance with ALA. CODE § 27-27-29 (1975), which requires the insurer to keep complete records of its transactions and affairs.

Title Agents' Certificates of Authority – Page 17

It is recommended that the Company obtain and maintain a certificate of authority for each of its title agents in accordance with the ALDOI Bulletin, dated July 12, 2001 [*The Alabama Title Insurance Act ALA. Act No. 2001-496*].

Written contracts between the Company and affiliates – Page 18

It is recommended that the Company execute a written contract between itself and its affiliated title agents, specifying the required provisions of the underwriting contract and the responsibilities of each party, as defined in the guidelines of Title

Insurance Agent Relations Standard 3 of the NAIC's Market Conduct Examiners Handbook.

It is also recommended that the Company submit the contract to the Commissioner of the ALDOI in accordance with ALA. CODE § 27-29-5 (1975), and ALDOI *Regulation No. 55*.

Underwriting and Rating – Page 18

Commission Schedule Agreement – Page 19

It is recommended that the Company execute a written agreement with its title insurance agents defining the commission paid to the title agents in accordance with ALA. CODE § 27-29-5 (1975), which states that "...the books, accounts and records of each party will be so maintained as to clearly and accurately disclose the precise nature and details of the transactions."

It is also recommended that the Company notify the commissioner in writing of its intention to enter into transactions involving itself and any person in its holding company system, as required in ALA. CODE § 27-29-5(5)(b) (1975).

Rates and form filings – Page 19

It is recommended that the Company file its forms with the ALDOI for approval from the Commissioner before issuing the policy in accordance with ALA. CODE § 27-14-8 (1975).

It is recommended that the Company submit rates, rating material, supporting information and policy forms to the ALDOI and obtain formal approval of the same prior to their use in accordance with ALA. ADMIN. CODE 482-1-123 (2001), and Underwriting & Rating Standard 6, of the NAIC's Market Conduct Examiners Handbook.

Claims – Page 20

Claims Handling Procedures – Page 20

It is recommended that the Company document its standards and methods concerning claims handling practices in accordance with guidelines and standards established by ALA. CODE § 27-27-29(a) (1975), ALA. ADMIN. CODE 482-1-125 (2003), and the NAIC's Market Conduct Examiners Handbook.

Privacy Policies and Practices – Page 21

Procedures to Limit Access to Personal Information – Page 21

It is recommended that the Company institute specific procedures for the “collection, use and disclosure of information gathered in connection with insurance transactions so as to minimize any improper intrusion into the privacy of applicants and policyholders” as defined in Standard 15 of the Title Insurance Company and Agent Operations/Management section of the NAIC’s Market Conduct Examiners Handbook.

Opt Out Method for Disclosure of Nonpublic Personal Financial Information – Page 22

It is recommended that the Company provide a reasonable means for a consumer to exercise the opt out method of disclosure of nonpublic personal financial information in accordance with the options defined in item A.(2)(b), *Examples, Reasonable opt out means*, of ALA. ADMIN CODE 482-1-122-.08 (2002).

Reinsurance – Page 23

Insolvency clause - Page 25

It is recommended that the Company include an insolvency clause in its reinsurance contracts in accordance with the requirements of item (a.) of paragraph 8, of *SSAP No. 62*, of the NAIC’s Accounting Practices and Procedures Manual, which states that “[t]he agreement must contain an acceptable insolvency clause...”

Maximum coverage by reinsurer - Page 26

It is recommended that the Company amend the reinsurance contract to include the maximum coverage provided by the reinsurer.

Accounts and Records – Page 26

It is recommended that the Company maintain its records in accordance with ALA. CODE § 27-27-29(a) (1975), which states, in pertinent part:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such

methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company complete its Annual Statement in accordance with NAIC instructions and guidelines thereto.

Common stock – Page 33

It is recommended that the Company maintain its assets in the State of Alabama in accordance with ALA. CODE § 27-27-29(b) (1975).

It is recommended that the Company report money market funds in accordance with *SSAP No. 30*, of the NAIC's Accounting Practices and Procedures Manual and Annual Statement Instructions for all future reporting purposes.

It is recommended that the Company obtain certificates for the missing issues of common stock and maintain complete records of its assets, transactions and affairs in accordance with ALA. CODE § 27-27-29(a) (1975).

It is recommended that the Company maintain a signed copy of the Securities Valuation Office's Compliance Certificate in accordance with ALA. CODE § 27-27-29 (1975).

It is recommended that the Company comply with *SSAP No. 46*, paragraph 17, of the NAIC's Accounting Practices and Procedures Manual and report the fair value of the investment in a subsidiary as the actual cost in *Schedule D – Part 2 – Section 2*.

It is recommended that the Company file annual SUB-2 forms on its subsidiary companies in accordance with the Securities Valuation Office's Purposes and Procedures Manual of the NAIC. It is noted that this recommendation has been made in the previous two examination reports.

Real estate – Page 35

It is recommended that the Company:

- (1) attempt to obtain a permitted practice from the ALDOI in order to amortize the difference between the \$132,485 (1993 market value of the Heritage Oaks property)

and \$103,961 (2002 depreciated cost) over a five-year period, and then carry the property at depreciated cost from that point forward; or
(2) reduce the property to depreciated cost in its next financial statement filed with the ALDOI, so as to be in accordance with *SSAP No. 40*, of the NAIC's Accounting Practices and Procedures Manual (Codification), as adopted by *ALDOI Regulation No. 97*.

It is recommended that the Company obtain appraisals for all admitted real estate properties in accordance with *SSAP No. 40*, of the NAIC's Accounting Practices and Procedures Manual and ALA. CODE § 27-37-7(b) (1975), which requires that an appraisal be no more than three years old. A similar recommendation was also made in the previous examination. Properties without recent appraisals should be not admitted from the balance sheet.

It is recommended that the Company utilize the guidelines for real estate appraisals as defined by *ALDOI Regulation No. 59*, in order to obtain a reliable appraisal that is acceptable to the ALDOI.

It is recommended that the Company maintain adequate insurance coverage on all of its properties in order to protect its investment in real estate.

It is recommended that the Company have a procedure in place to handle decline in real estate value in accordance with *SSAP No. 40*, paragraph 9, of the NAIC's Accounting Practices and Procedures Manual. In the event it is determined that the carrying value of the asset may not be recoverable, the Company should adjust the asset to fair value and write-off impaired asset in accordance with *SSAP No. 5*, of the NAIC's Accounting Practices and Procedures Manual.

It is recommended that the Company comply with *SSAP No. 5*, of the NAIC's Accounting Practices and Procedure Manual by reporting rental income received in advance under *Aggregate write-ins for other liabilities* in accordance with the NAIC's Annual Statement Instructions.

Cash and Short-term investments – Page 38

It is recommended that the Company maintain its assets in the state in accordance with ALA. CODE § 27-27-29(b) (1975).

It is recommended that the Company report money market funds that are not listed under the exempt list of bonds or as Class 1 funds in the Securities Valuation Office's Purposes and Procedures Manual of the NAIC as common stock in *Schedule D – Part 2 – Section 2*, in accordance with the NAIC's Annual Statement Instructions, and *SSAP No. 30*, of the NAIC's Accounting Practices and Procedures Manual.

Title insurance premiums and fees receivable – Page 39

It is recommended that the Company perform analyses and determine if the fees charged to its affiliates are fair, reasonable and at arm's length, as required by ALA. CODE § 27-29-5(a) (1975), and *SSAP No. 25*, of the NAIC's Accounting Practices and Procedures Manual. This recommendation was also made in the previous examination report.

It is recommended that the Company evaluate its premiums and fees receivable and make a determination as to the collectibility of the recoverables. If it is probable that the amount is uncollectible, the asset should be considered impaired and charged to operations in accordance with *SSAP No. 5*, paragraph 7, of the NAIC's Accounting Practices and Procedures Manual. A similar recommendation was made in the previous examination report.

Other expenses – Page 41

It is recommended that the Company record liabilities arising from economic benefit received in accordance with *SSAP No. 5*, of the NAIC's Accounting Practices and Procedures Manual, and establish adequate accruals for *Other expenses* in its financial statements in accordance with the NAIC's Annual Statement Instructions.

Federal and foreign income taxes – Page 41

It is recommended that the Company execute and submit for approval to the Commissioner of the ALDOI, a written tax agreement in accordance with the relevant sections of the *Alabama Insurance Code*, and the NAIC's Annual Statement Instructions. This recommendation was also made in the previous examination report.

It is recommended that the agreement be adopted by the Board of Directors of each company and documented in the appropriate minutes of the meetings of the same. This recommendation was also made in the previous examination report.

It is recommended that the Company follow the representations made in its Form B filings and in the Annual Statement *NOTES TO FINANCIAL STATEMENTS* and settle all intercompany tax balances annually in the first quarter of the year. A similar recommendation was also made in the previous examination report.

Contingent Liabilities and Pending Litigation – Page 43

It is recommended that the Company provide all information requested by the examiners, including inquiries to attorneys, in accordance with *ALDOI Regulation No. 118*, which states:

“The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner.”

Compliance with ALDOI Regulation No. 60

It is recommended that the Company file future Annual Statements in accordance with the last filed Report of Examination, pursuant to *ALDOI Regulation No. 60*.

SUBSEQUENT EVENTS

Reviews conducted on selected records and transactions subsequent to the examination period did not disclose or reveal any noteworthy items. There were no actions that would impact the financial statements as of the examination date. In response to the examiners' inquiries, the Company's President, responded that no significant subsequent events have occurred since December 31, 2002.

CONCLUSION

Acknowledgement is hereby made of the courteous cooperation extended by the officers and employees of the Company during the course of this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and evaluation of assets and determination of liabilities set forth in this report.

In addition to the undersigned, F. Blase Abreo, CFE, Thomas Dan Norton and Angeline Wages, Examiners, all representing the Alabama Department of Insurance, participated in this examination of *Gulf Coast Title Insurance Company, Incorporated*.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Anne L. Ward", written over a horizontal line.

Anne L. Ward, AFE
Examiner-in-Charge
State of Alabama
Department of Insurance

November 3, 2004